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IN THE

Supreme Court of the United States

OCTOBER TERM, 1963

No. 755

Estate of RALPH SLOCUM DAVENPORT, deceased,
UNITED STATES TRUST COMPANY OF NEW YORK, Executor,
Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit.

Opinions Below

The opinion of the Tax Court (R. 3a-7a) is reported at 38 T.C. 670 (1962). The opinion of the Court of Appeals (Appendix A, *infra*, pp. A-1 to A-6) is reported at 321 F.2d 908 (1963).

Jurisdiction

The judgment of the Court of Appeals (Appendix A, *infra*, p. A-7) was entered September 3, 1963. Petitioner

filed petitions for rehearing and rehearing *en banc* (R. 60a), thus staying, under Rule 25(c) of the Rules of the United States Court of Appeals for the Second Circuit, issuance of a mandate pending disposition of the petitions. The petitions were denied October 17, 1963 (Appendix A, *infra*, pp. A-9, A-10). The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

Questions Presented

The decedent died July 18, 1955, leaving two wills, one disposing of his property situated in the United States, and another purporting to dispose of certain real estate situated in France. In the first will, hereinafter described as "the American will", decedent's widow was devised one-sixth of his residuary estate outright and two-sixths of his residuary estate in trust for life, with a power of appointment by will. The American will was admitted to probate in the State of New York on September 23, 1955 without objection by any interested party. More than a year later, on November 8, 1956, the widow released the power of appointment described above in an agreement under which the decedent's daughters consented to probate of the other will, "the French will", purporting to devise to the widow full ownership of the decedent's home in France. The questions presented are:

(1) In view of the decisions of this Court and of various Circuit Courts of Appeal as to the applicability of state law in determining property rights in Federal revenue cases, could the Court of Appeals totally ignore the law of New York in concluding that the two-sixths interest in the decedent's residuary estate did not pass to the widow for purposes of the estate tax marital deduc-

tion provided in Section 2056(a) of the Internal Revenue Code?

(2) Does the decision of the Tax Court determining an estate tax deficiency, unsupported by the facts of record, unsupported by any relevant or logical grounds of law, conflicting with its own conclusion in a subsequent case, and interpreting an inapplicable regulation, represent an unconstitutional taking of petitioner's property without due process of law?

Statutes and Regulations Involved

The pertinent statutes and regulations appear in Appendix B, *infra*, pp. B-1 to B-4.

Statement of the Case

The decedent, who was a United States citizen and a resident (domiciliary) of New York City, died July 18, 1955 in Paris, France, survived by his wife, Mrs. Yvonne Davenport, and by three adult daughters of a former marriage, Mrs. Myriam Williford, Mme. Solange du Mortier, and Miss Gisele Davenport, now Mrs. Donald Payne (R. 14a). At the time of decedent's death, Mrs. Williford and Miss Davenport were residing in the United States, and Mme. du Mortier made her home with Dr. and Mrs. Davenport at the decedent's villa, "La Falaise", in Sanary-sur Mer (Var), France (R. 14a).

On May 19, 1949, while a resident of New York State, Dr. Davenport had executed a will, hereinafter referred to as "the American will" (R. 15a). This will disposed of all of his property other than French real property, which was devised by a holographic will in French dated October 4, 1939 (R. 17a, 24a). The holographic will of October 4, 1949, which is not at issue here, was super-

seded by a new holographic will dated June 28, 1955, which is hereinafter referred to as "the French will" (R. 25a, 26a).

Under the terms of the American will, after bequests of personal effects, jewelry, books, etc., Dr. Davenport's residuary estate was devised and bequeathed as follows: one-sixth outright to each of his three daughters; one-sixth outright to his wife, Yvonne; two-sixths to his testamentary trustees for the benefit of his wife, Yvonne, for life, with power to her to dispose of the principal by will (R. 17a, 18a).

In his French will of June 28, 1955, Dr. Davenport, *inter alia*, attempted to devise to his widow full ownership of his villa in France, known as "La Falaise" (R. 25a), although he acknowledged in the will that the provisions thereof "may be regarded as exceeding the disposable quota established by French law" (R. 26a).

In August, 1955 the decedent's widow and three daughters, all of the distributees, waived citation and consented to the probate of the American will in the Surrogate's Court of New York County (R. 15a, 27a). On September 23, 1955 the American will was admitted to probate by the Surrogate's Court of New York County without objection and with the consent of all the interested parties (R. 15a, 16a).

Under the law of France, which applies to the distribution of French real property regardless of a decedent's domicile or nationality and regardless of the terms of decedent's will (R. 40a, 42a), Mrs. Davenport could not obtain more than a one-fourth interest in "La Falaise" without the express consent of the three daughters to the probate of the French will (R. 40a, 41a, 42a). The probate of the French will and passage of full title to the

widow could only be accomplished, under French law, by the execution by the daughters of an "Acte de Deliverance de Legs" (Document of Delivery of the Legacy) and the filing of such document with the "Conservateur des Hypotheques" (Keeper of the Public Records) (R. 42a-45a). During the interval between the date of death and the date of an execution of the "Acte of Deliverance" by the daughters, Mrs. Davenport's interest in "La Falaise" was limited to a one-fourth interest despite the provisions of the French will (R. 45a).

At no time prior to November 8, 1956, more than 15 months after Dr. Davenport's death and more than 13 months after probate of the American will, did the daughters agree to consent to the probate of the French will (R. 48a).

On February 6, 1956, Mrs. Davenport retained Alexis Coudert, Esq., of the firm of Coudert Brothers in New York City, to negotiate with counsel for the three daughters in order to obtain for her full possession and title to "La Falaise" (R. 46a, 48a, 49a).

Beginning on February 9, 1956, Mr. Coudert conducted negotiations with counsel for the daughters consisting of a number of conferences and telephone calls concerning a possible agreement between the parties (R. 48a). As a result of these negotiations conducted between Mr. Coudert and counsel for the daughters at arms' length and as adversaries representing conflicting interests, the parties as of November 8, 1956 entered into an agreement by which Mrs. Davenport released her power of appointment over two-sixths of the decedent's American residuary estate, and the daughters agreed to consent to the probate of the French will, enabling Mrs. Davenport to take full title to "La Falaise" (R. 29a, 48a, 49a). Mrs. Davenport's

release was not to be effective until the daughters had executed the documents necessary under French law to effectuate probate of the French will and had filed these documents with the appropriate French authorities (R. 29a).

Throughout the negotiations, Mr. Coudert had taken the position that Mrs. Davenport would not release her power of appointment unless she obtained full title to the French villa (R. 49a). The agreement by the daughters to give effect to the French will was the consideration for Mrs. Davenport's release of her power of appointment under the American will (R. 49a).

At no time during these negotiations did counsel for the daughters raise a question of fraud, lack of testamentary capacity, undue influence, duress or coercion in the execution of the decedent's American will (R. 49a, 50a). At no time did they allege fraud with respect to the American probate proceedings or indicate any intent to move to vacate the American probate proceedings (R. 50a).

The French will was probated in April, 1957 (R. 51a). On April 19, 1957, after the probate of the French will, giving Mrs. Davenport title to "La Falaise", Mrs. Davenport's release of her power of appointment was delivered to the executor as trustee in accordance with the terms of the agreement dated November 8, 1956 (R. 16a).

The Commissioner disallowed the marital deduction claimed by the estate with respect to the two-sixths interest in the residuary estate, contending that the said interest did not pass to the decedent's widow. He relied on Regs. Sec. 20.2056(e)-2(d)(1),[2] which provides:

> (d) "*Will contests.* (1) If as a result of a controversy involving the decedent's will, or involving any bequest or devise thereunder, his surviving spouse

> assigns or surrenders a property interest in settlement of the controversy, the interest so assigned or surrendered is not considered as having 'passed from the decedent to his surviving spouse' ".

The Tax Court sustained the Commissioner's determination of an estate tax deficiency of $87,823.69 (R. 2a-7a). The Court of Appeals affirmed the decision of the Tax Court (Appendix A, *infra*, p. A-1). The Tax Court had acquired jurisdiction upon the filing of a petition therein pursuant to Section 6213(a) of the Internal Revenue Code, 26 U.S.C. §6213(a).

Reasons for Granting the Writ

The Court of Appeals' conclusions that the law of the State of New York is not determinative of whether two-sixths of the decedent's residuary estate passed to the decedent's widow; and that "for federal tax purposes, the federal regulations govern" (Appendix A, *infra*, p. A-6) are in conflict with decisions of this Court and of various Courts of Appeals dealing with the applicability of state law in Federal revenue cases. Moreover, the affirmation of a Tax Court decision without any factual or rational basis is a violation of the United States Constitution, Fifth Amendment, in that the petitioner is deprived of its property without due process of law. The Court of Appeals thus "so far departed from the accepted and usual course of judicial proceedings, or so far sanctioned such a departure by a lower court, as to call for an exercise of this court's power of supervision." (Rule 19(1)(b) of the Rules of this Court.)

I.

The decision of the lower court is in conflict with decisions of this Court and of other circuits on the applicability of state law in Federal tax matters.

The question of whether, and under what circumstances, state law is determinative in the resolution of issues arising under the Federal revenue laws has long been settled by the decisions of this Court. In *Burnet* v. *Harmel*, 287 U. S. 103, 110 (1932) the Court said:

> "Here we are concerned with the meaning and application of a statute enacted by Congress, in the exercise of its plenary power under the Constitution to tax income. The exertion of that power is not subject to state control. It is the will of Congress which controls, and the expression of its will in legislation, in the absence of language evidencing a different purpose, is to be interpreted so as to give a uniform application to a nation-wide scheme of taxation * * * *State law may control only when the operation of the Federal taxing act, by express language or necessary implication, makes its operation dependent upon State law.*" (Emphasis added.)

In 5 Rabkin and Johnson, Federal Income, Estate and Gift Taxation, Sec. 71.08, it is stated that "since the income, estate and gift taxes are imposed by Federal statute, all questions of liability are ultimately to be resolved under Federal law. *Nevertheless, where the tax depends upon a property right, the existence of that right must be determined under the local law.* * * * Where the tax statute expressly or impliedly prescribes the taxpayer's property right as the test of taxability, then the existence

of that right must be discovered under the controlling local law [citing *Blair* v. *Commissioner*, 300 U. S. 5 (1936), and *Helvering* v. *Stuart*, 317 U. S. 154 (1942)]." (Emphasis added.)

In *Helvering* v. *Stuart*, *supra*, the Court was called upon to decide whether title to a trust corpus could be revested in the grantor and whether the trust income could be distributed to him. The Court said:

> "When Congress fixes a tax on the possibility of the revesting of property or the distribution of income, the 'necessary implication', we think, is that the possibility is to be determined by the state law * * * The power to transfer or distribute assets of a trust is essentially a matter of local law * * * Congress has selected an event, that is the receipt or distributions of trust funds by or to a grantor, normally brought about by local law, and has directed a tax to be levied if that event may occur. Whether that event may or may not occur depends upon the interpretation placed upon the terms of the instrument by state law. *Once rights are obtained by local law, whatever they may be called, these rights are subject to the Federal definition of taxability.*" (Emphasis added.)

This Court phrased the same rule in a slightly different way in *Morgan* v. *Commissioner*, 309 U. S. 78, 80 (1940) in saying, "State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed."

The case at bar provides a particularly appropriate occasion for reference to state law to determine what interests and rights were created, *before* determining under the Federal statute and regulation the tax status (in this case, the deductibility) of such interests and

rights, or the tax consequences of their creation. Here indeed is presented a situation where the deduction depends upon a property right; and in defining that right, the "necessary implication" is that state law must be heeded. In ignoring New York law, the Court of Appeals likewise ignored the principles announced by this Court in the foregoing cases, and the decision below stands in conflict also with the Court of Appeals' own decisions and those of other circuits.

Section 2056(a) of the Internal Revenue Code provides as follows:

> "Sec. 2056. BEQUESTS, ETC. TO SURVIVING SPOUSE
>
> (a) Allowance of Marital Deduction.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsections (b), (c), and (d) be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate."

Regs. Sec. 20.2056(e)-2(a) state that "A property interest is considered as passing to the surviving spouse only if it passed to her as beneficial owner * * *".

We cannot conceive how the crucial passage of ownership as described can be determined without reference to local law. There is no provision in the Internal Revenue Code or Regulations governing the marital deduction (Section 2056) where Congress has attempted to define "beneficial ownership", unlike other provisions of the estate tax law (*e.g.* Sections 2035, 2037, 2038, and 2040) where special rules do supersede local law concepts. A

Federal statute referring to the "passing" of property from a decedent to his surviving spouse, and an interpretive regulation holding that "passing" means a vesting of "beneficial ownership", very clearly depend for their operation on what constitutes beneficial ownership under local law.

The thrust of petitioner's argument below was that under the law of New York, Mrs. Davenport became absolutely entitled to the power of appointment over two-sixths of her husband's residuary estate upon the uncontested probate of the American will there on September 23, 1955. The property interest "passed" to her as beneficial owner on that date. Her disposition of that interest by the agreement of November 8, 1956 was a "subsequent conversion" which the Treasury Regulations themselves state is immaterial for purposes of determining the eligibility of an interest for the marital deduction (Regs. Sec. 2056(b)-1(e)(3)). Accordingly, the estate is entitled to the full marital deduction claimed, regardless of the later exchange or disposition by Mrs. Davenport of an interest that passed to her under the will.

Under the law of New York, a power of appointment conferred under a will passes to the donee of the power upon the probate of the will of the donor. If the will is denied probate, the power never comes into existence. See 3 Jessup-Redfield, Law and Practice in the Surrogate's Court of the State of New York, Sec. 2652 (Rev. ed. 1949). See also 7 Warren's Heaton Surrogate's Courts, Sec. 73(2) (6th Rev. ed. 1951); *Matter of Johnson*, 19 N.Y.S. 963 (1892).

That there was no conceivable cloud on Mrs. Davenport's ownership of the power of appointment is evidenced by the fact that the daughters had executed waivers of

citation, thereby consenting to the probate of the American will. Under Surrogate's Court Act, Sec. 41-3(a), by so doing they not only consented to probate but they also became parties to the probate proceeding. As parties to the proceeding they were bound by the resulting decree. Surrogate's Court Act, Sec. 80. Thus, once the will was probated, Mrs. Davenport's exercise of the power under her own will would have been valid even if she had died July 19, 1955, one day after the death of her husband. Cf. *Matter of Fowles*, 222 N. Y. 222 (1918). Since she survived, the power clearly was Mrs. Davenport's to use as she pleased on September 23, 1955 and thereafter. She could have contracted to exercise the power of appointment for a consideration in cash; she could have retained it with or without exercising it; or she could have given it away. In any of these events, the full marital deduction could not have been denied, since the power had already passed to her.

The Court of Appeals, however, chose to accord no weight to the law of New York, or to the conclusive effect of the probate decree with respect to the American will. The court apparently was not concerned with how, or whether, any property interests were created. It mistakenly assumed that there was a "controversy" about the decedent's will and property (see Part II, *infra*) and automatically applied the Federal tax regulation (Regs. Sec. 20.2056(e)-2(d)(1)) relied on the Commissioner, concluding (Appendix A, *infra*, p. A-6):

> "We find no merit to the appellant's theory that because under New York law Mrs. Davenport acquired vested rights in the trust property, this property passed to her from the decedent and her subsequent relinquishment of her power of appointment did not affect the marital deduction. For

federal tax purposes, the federal regulations govern, *Lyeth* v. *Hoey*, 305 U. S. 188 (1938). The regulation is clear: it provides that where an agreement resolving a controversy over the decedent's property entails the assignment or surrender of property by the surviving spouse, said property 'is not *considered* as having passed from the decedent to his surviving spouse' * * * *No matter how or at what time Mrs. Davenport became entitled to the residue*, she did choose to surrender a right to some of the decedent's property because she wanted 'La Falaise', which was also a part of the decedent's estate." (Emphasis added.)

The Court of Appeals' conclusions that it was immaterial how and when Mrs. Davenport became entitled to the American property, and that New York law on this point does not govern, are squarely in conflict with the rulings of this Court cited and quoted above.[1] If it is true that state law creates legal interests and rights, and the federal revenue acts designate what interests and rights, *so created*, shall be taxed, it follows that before Federal tax laws can operate with respect to a property interest, it

[1] The court's reliance upon *Lyeth* v. *Hoey*, *supra*, is clearly misplaced. Not only did this Court therein re-state the rule of *Burnet* v. *Harmel* as to the applicability of state law (305 U. S. 194), but ceded to state law the predominant effect in the areas of probate procedure and processes of administration (305 U. S. 193). If New York law governing the procedure for the probate of wills, rather than Federal law, is applicable, it follows that heed must be given to the New York law—unchallenged by the Commissioner—to the effect that once the Davenport will was probated, the daughters had no further claim to the power of appointment given to Mrs. Davenport under that will; that there was and could be no "controversy" about it; and hence, that the power passed to Mrs. Davenport upon that event. Finally, we should note that in *Lyeth* v. *Hoey* a will was offered for probate, but was objected to on various grounds. Thereafter the parties entered into a compromise agreement. Since the facts of that case are distinguishable, the reasoning therein would have no application here even if the same legal question were involved.

must be determined under state law whether and how an interest arose. This principle the Court of Appeals refused even to consider here.

Moreover, the Court of Appeals' decision is in conflict with the conclusion of the Court of Appeals for the Fifth Circuit in *Frederich* v. *Commissioner*, 145 F.2d 796, 798 (1944) that "It will not be assumed that Congress intended to interfere with the jurisdiction and power of local courts in the administration of estates by conferring upon the Commissioner of Internal Revenue the power to disregard valid orders of the probate court made in the course of the administration and settlement of an estate unless the language of the grant is so express and unequivocal as to admit of another construction". The Surrogate's Court of New York County here admitted the American will of the decedent to probate, which under New York law vested title to the power of appointment in the widow. To conclude, as have the Commissioner and the courts here, that this property interest had not passed to her on that event, is to disregard the "valid orders of the probate court made in the course of the administration and settlement of (the) estate."

Other cases in which the several Courts of Appeals have ruled that state law is of governing effect in Federal revenue cases are *Lincoln Storage Warehouses* v. *Commissioner*; 13 T.C. 33, aff'd 189 F.2d 337 (C.A. 3, 1950); *Phillips Petroleum Co.* v. *Jones*, 176 F.2d 737 (C.A. 10, 1949), cert. den. 2-20-50; *Goold* v. *Commissioner*, 182 F.2d 573 (C.A. 9, 1950); and *Graves, Inc.* v. *Commissioner*, 202 F.2d 286 (C.A. 5, 1953), cert. den. 10-12-53.

The Court of Appeals' decision is even contrary to its own rule set forth in *Fidelity & Deposit Co.* v. *New York City Housing Authority*, 241 F.2d 142, 144 (1957), a case

dealing with the lien provisions of the Internal Revenue Code:

> "Section 3670 imposes a tax lien on 'all property and rights to property' of a defaulting taxpayer. In adopting this legislation, the Congress did not create property interests on which a lien might be imposed; there is no suggestion that it authorized the federal courts to do so. *On the contrary, it took for granted here, as it normally does in the tax law, the vital existence of state laws creating and maintaining various interests.* The statute was fashioned to require the courts to determine for federal purposes whether those state-created interests are 'property' or 'rights to property'. *That classification of interests is a federal question; the existence of the interests to be federally classified, however, is solely a question of state law.* (Emphasis added.)
>
> "This distinction was formulated by the Supreme Court in Morgan *v.* Commissioner, 309 U. S. 78, 80, 60 S. Ct. 424, 426, 84 L. Ed. 585, which also involved the tax law * * *."

If we assume that Mrs. Davenport's property had become subject to a Federal tax lien after September 23, 1955, the date of probate of the American will, it is clear that the court below, under its *Fidelity & Deposit Co.* rule, necessarily would have determined the validity of any claim by the Commissioner against the property interests passing to her under Dr. Davenport's American will by looking to the New York law. The New York law, as indicated above, is that the widow became the beneficial owner of these interests upon the uncontested probate of the will, and such interests would have been "property and rights to property" subject to a Federal tax lien. It

is not at all clear why the Court of Appeals was so reluctant to consider the effect of New York law in the case at bar.

In view of the foregoing, the judgment below should be reviewed by this Court.

II.

There is no evidence from which the Tax Court or the Court of Appeals could reasonably have concluded that there was a "controversy involving the decedent's will, or involving any bequest or devise thereunder". Therefore, their decision that the release of Mrs. Davenport's power of appointment "in settlement of a controversy" precludes deduction of two-sixths of the decedent's residuary estate under Sec. 2056 of the Internal Revenue Code is a deprivation of petitioner's property without due process of law, prohibited by the U. S. Constitution.

Essential to the decision both of the Tax Court and the Court of Appeals here was a determination that, within the meaning of Regs. Sec. 20.2056(e)-2(d)(1), there was a "controversy involving the decedent's will, or involving any bequest or devise thereunder". If there was no such controversy "in settlement of" which the surviving spouse surrendered a property interest, the marital deduction cannot constitutionally be denied the petitioner.

There was no controversy about the decedent's American will or American property. The Tax Court so found as a fact. It said (R. 4a):

> "[The American] will was admitted to probate on September 23, 1955, in New York without objection. Its validity and effect were never challenged or questioned."

The Tax Court did *not* find as a fact that there was a controversy about the French will or any devise or bequest thereunder. Its findings of fact include solely the following statement with respect thereto (R. 4a):

> "The other will, herein called the French will, *purported to devise* the decedent's real estate in France to Yvonne. However, each of the three daughters became entitled under the law of France to a one-fourth interest in that real estate at the death of their father and they would not consent to the probating of the will giving all that property to Yvonne. Attorneys for the four survivors then entered into negotiations which led to an agreement executed by Yvonne on November 8, 1956, providing in substance that the French will would be probated, giving her the real estate in France, in accordance with the French will, and she would surrender her power of appointment over the two-sixths of the residuary estate left in trust for her for life under the American will. The French will was then probated in April 1957 and thereafter Yvonne delivered to the trustee on April 19, 1957, her release of the power of appointment over the trust corpus." (Emphasis added.)

There is nothing in the Tax Court's *findings of fact* (nor in the record) that reasonably supports (1) the Tax Court's sweeping statement in its *opinion* (R. 6a) that "there was a real controversy in regard to his attempted disposition by will of his real estate in France"; or (2) the legal conclusion of either court below that the circumstances leading to the November 8, 1956 agreement constituted a "controversy * * * in settlement of which" the surviving spouse made a transfer of property, fatal to the marital deduction.

Both courts assumed without even discussing the point that there was a genuine controversy about the decedent's testamentary scheme, and proceeded from there to apply the cited section of the Regulations. Both courts made erroneous assumptions about the nature of the negotiations with respect to the French property, and the nature of the property interests involved on both sides. Both courts failed to grasp the essential fact that there was no will contest threatened here as to *either* will.

With respect to the American will, there was no contest or controversy, as the Tax Court found; and the interests therein devised to Mrs. Davenport vested upon probate in New York, as discussed above.

With respect to the French will, to the extent such will purported to devise to Mrs. Davenport more than a one-fourth interest in the French villa, it was a *legal nullity* from the moment it was drafted, as the decedent acknowledged in the instrument itself. There was not and could not have been any "controversy" with respect to the villa, or the will purporting to devise it: The daughters did not have to do anything to challenge Mrs. Davenport's supposed "rights" to this property (as is customary and implicit in a will contest): three-fourths of it was irrevocably theirs, a right fixed at and from the moment of their father's death. Mrs. Davenport could not have challenged this right at French law. If no one had offered the will for probate or taken any other steps in the matter, the daughters would have continued to hold a three-fourths interest in La Falaise in fee, and the claimed marital deduction would have gone undisturbed, as the Commissioner conceded (R. 36a-37a).

The November 8, 1956 agreement resulted because Mrs. Davenport wanted full title to the French villa, and the

decedent's daughters by a prior marriage were unwilling to give effect to their father's wish, *unenforceable at law*, that she have it. They stood on their rights and bargained the probate of the otherwise ineffective French will in return for Mrs. Davenport's release of her power. This is the same type of "dispute", "controversy" or "conflict of interests" inherent in any arms' length negotiations, where each of two parties bargain for something to which the other has a vested right. The daughters had vested rights in three-fourths of the French villa, and Mrs. Davenport had a vested right in the power of appointment.[2] As in any other arms' length agreement, the parties on both sides chose to give up something each owned, in return for something each wanted more. They made and carried out a bargain and sale agreement effectuating these desires. It was as simple as that. Such a "controversy" is not the type envisioned in Regs. Sec. 20.2056 (e)-2(d)(1). The cited paragraph of the regulations is headed "Will contests". This type of controversy

[2] The Tax Court judge acknowledged this at the trial when he said, in a colloquy with the Commissioner's counsel (R. 37a, 38a):

"It would seem that [the daughters] were receiving only one-sixth each of their father's American estate, and they were getting one-fourth each of this property in France under the law, and the widow preferred to have the entire French property and in that connection was willing to give up her power of appointment on that one-third in this country. So after the decedent was dead they merely entered into such an arrangement. Now, if those are the facts, I don't blame you for wanting a reply brief, but I don't know what your original brief would be * * * if I understand it correctly, it would seem to me that the law covered this. These people had a right to do what they did. But the law of inheritance and devise and so forth and *the laws of New York*, or wherever it was, bearing upon this will, *gave these people these rights, and the widow didn't have to do what they (sic) did if she didn't want to, or the children, so after the rights were established they changed their rights by agreement* * * *. As I have indicated, if I understand the question, I don't think that Uncle Sam is doing very well * * *." (App. 37a, 38a) (Emphasis added.)

Neither court below seems to have "understood the question" quite as clearly as did the judge at the trial.

does not imply the bargaining between adverse interests that took place here; it implies an actual or threatened law suit for the purpose of upsetting a will. *That is not this case.*

The fundamental flaw in the conclusion of the courts below is readily apparent if one assumes that Mrs. Davenport had surrendered her power of appointment, or contracted to exercise it in the daughters' behalf, and the daughters in exchange had conveyed their interests in the villa to her by deed. (This was their right, since a one-fourth interest had vested in each at the father's death.) This would have satisfied Mrs. Davenport's desire for full title to the villa without involving the French will at all. In such event, there would have been no "controversy" upon which the marital deduction could be denied (unless there had been a threat to contest the validity of the New York will which, the Tax Court found, was "never challenged or questioned"). We cannot see why the result should be different because Mrs. Davenport's desires were satisfied in another way, *i.e.*, by the probating of the French will containing an otherwise ineffective disposition of the villa.

A clear example of a case properly invoking the "will controversy" section of the Treasury Regulations is *Estate of Thomas W. Tebb* v. *Commissioner*, 27 T.C. 671 (1957). There the surviving spouse surrendered the residuary estate left her under her husband's will in order to avoid a will contest—a law suit—over that will. She took in exchange a "terminable" or life interest in the same property. This agreement was entered into while the will was still subject to contest under local law and while Mrs. Tebb's rights remained unfixed. Regs. Sec. 20.2056(e)-2(d)(1) is designed to cover such a case, and

not that of Mrs. Davenport, who surrendered property that, under local law, had passed or vested in her without contest and without the possibility of a contest.[3]

The intent of the "will controversy" clause of the Regulations is to disqualify a "terminable interest", as in *Tebb*, from the marital deduction. The theory is that property of which a spouse does not actually receive unrestrained ownership should not serve to reduce the gross estate for estate tax purposes. The Commissioner's Regulations, Sec. 20.2056(b)-1(e)(3), also provide:

> "Whether or not an interest is nondeductible because it is a terminable interest is to be determined by reference to the property interests which *actually passed* from the decedent. *Subsequent conversions of the property are immaterial for this purpose* • • •". (Emphasis added.)

The courts below ignored the plain fact that the power of appointment *actually passed* to Mrs. Davenport upon probate of the American will in September, 1955. Her interest thereupon was no longer terminable, but was a vested interest. Her exchange of this interest 14 months

[3] Under the laws of the State of Washington, as indicated in *Tebb*, probate is not final until the expiration of a statutory period thereafter during which a court contest may still be instituted. Under the laws of the State of New York "every decree of a surrogate's court is conclusive as to all matters embraced therein against every person of whom jurisdiction was obtained." Surrogate's Court Act, Section 80. Since the daughters of Dr. Davenport were subject to the jurisdiction of the Surrogate's Court of New York County, the time for contesting the Davenport will expired on September 23, 1955. (The grounds for opening or vacating the probate of a will in New York are fraud, newly discovered evidence of some infirmity with respect to the will or the probate procedure, clerical error, or causes of like nature. Surrogate's Court Act, Section 20(6). As Mr. Coudert testified, none of these grounds was ever advanced by any of the daughters at any time, and the Tax Court found that the validity and effect of the American will were never challenged or questioned.)

later in return for the French real estate was a *subsequent conversion*, which the Commissioner himself finds by regulation to be immaterial to the deductibility of the interest.

The Tax Court completely ignored, in its findings of fact and opinion, the uncontradicted testimony of Mrs. Davenport's counsel, Mr. Coudert, that Mrs. Davenport would not have agreed to surrender the power of appointment if the daughters had not agreed to the probate of the French will, and that such agreement by the daughters was the consideration for the surrender of the power (R. 49a). If Mrs. Davenport could surrender the power or not, as she chose, and if she bargained it away only in return for the "fresh consideration" demanded by her, how can it be contended that this property interest had not "passed" to her within the meaning of Section 2056? What greater evidence of beneficial and unrestrained ownership of the property could there be than this?

The Court of Appeals erroneously assumed in its opinion (Appendix A, *infra*, pp. A-4, 5) that petitioner had conceded that there was a "will controversy"; and that the "theory underlying" our argument was that Regs. Sec. 20.2056(e)-2(d)(1) does not apply where a decedent leaves two wills, one of which is probated without contest while the other is subject to a controversy. As we carefully explained in our petition for a rehearing in the Court of Appeals (Pet. pp. 4-8, R. 63a-67a) this was an alternative to our principal contentions that the power of appointment released by Mrs. Davenport had passed to her under New York law, and that there was no will controversy involved here. The court ignored these contentions and proceeded to decide the case on a subsidiary point without ever determining that there was, in fact, a controversy about

the French property. The unusual circumstance of a domestic and a foreign will has been a source of confusion throughout this case, as indicated in the opinions of both courts below. Both courts have placed entirely unwarranted emphasis upon this irrelevant phase of the case, while overlooking the central fact of record that there was no controversy about either will.

In summary, petitioner contends there was no controversy here which forced Mrs. Davenport to yield part of her American legacy; it was the exercise of her right of independent choice to exchange one of her vested property interests for another interest of more subjective value, that led to the agreement of November 8, 1956. This is quite a different matter from a court proceeding or controversy, threatening to deprive a spouse of property not yet vested, that she chooses to avert by yielding part or all of the very property threatened.

The judgment against petitioner clearly lacks any rational connection with the facts of record herein. There being no factual basis of record for the conclusion that there was a controversy involving the decedent's wills and the property devised thereunder, the judgment below that Regs. Sec. 20.2056(e)-2(d)(1) is applicable here—resulting in a deficiency in estate tax—represents an unconstitutional taking of property from the petitioner without due process of law. The case merits review of this Court on this ground also. Judgments totally unsupported by evidence constitute a violation of the due process clause. *Thompson* v. *Louisville*, 362 U. S. 199 (1960); *Schware* v. *Board of Bar Examiners*, 353 U. S. 232 (1957); *Tot* v. *United States*, 319 U. S. 463, 473 (1943) (concurring opinion).

III.

The decision below violates the due process clause in that this case involves a statute inapplicable on its face to foreign real estate. Any so-called "controversy", relating thereto is, therefore, beyond the scope of a regulation interpreting such a statute.

As a matter of proper statutory interpretation, one cannot even inquire into a "controversy" about a French will devising or purporting to devise French real estate, for purposes of determining the marital deduction. Code Section 2056(a), on its face, limits the marital deduction to assets (1) which are included in the gross estate and (2) which pass to the surviving spouse. The Regulations interpreting that section, including the "will controversy" provision involved here, can only be invoked to construe situations where property was included in the gross estate and a marital deduction was claimed with respect thereto. Absent such a situation, neither Section 2056(a) of the Internal Revenue Code nor its underlying Regulations are even brought into play. Property like the Davenport villa, "La Falaise", which was never an asset for United States estate tax purposes, nor claimed as part of the marital deduction, is beyond the scope of the Code and, therefore, of its interpretive regulations[1]; there is thus no occasion to consider any "controversy" involving it, particularly when the devolution of this property did not affect in any way the right of Mrs. Davenport to her interests under the American will. To determine a tax deficiency on the basis of an inapplicable regulation is a violation of due process.

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[1] The exemption of foreign realty from estate tax was removed by Sec. 18(a)(2)(A), Pub. L. 87-834, October 16, 1962, 76 Stat. 1052, amending Section 2033, I. R. C.

IV.

In a subsequently decided case, in which the Commissioner has already acquiesced, the Tax Court has employed reasoning and reached a conclusion inconsistent with its reasoning and conclusion in this case. Therefore, it was a violation of due process for the Court of Appeals to sanction the Tax Court's decision in favor of the Commissioner under such circumstances.

At the conclusion of its opinion below (R. 7a), the Tax Court stated:

> "The widow and the three daughters in effect substituted distributions of property different from that stated in the wills and the substitution relating to the trust estate does not qualify for the marital deduction."

This is inconsistent with the Tax Court's reasoning and conclusion in the case of *Isaac Harter, Jr.* v. *Commissioner*, 39 T.C. No. 50 (1962), decided subsequently to the case at bar. In that case the decedent by her will left her entire estate to her son, the petitioner. Decedent's husband, pursuant to a discussion with the petitioner, elected to take his share of his wife's estate as in intestacy pursuant to local law, and thereby effect a tax saving through the marital deduction. On the same day the husband received his intestate share, he divided it into three equal parts and gave one to each of the son's three children, two parts being given in trust. The Commissioner contended that the estate was not entitled to the marital deduction for the share validly passing to the husband under his election to take by intestacy, because he immediately gave his interest to his grandchildren.

Therefore, the Commissioner urged, the election by the husband should have been considered a nullity, and the property deemed to have passed directly to the grandchildren and not to the surviving spouse.

The Court held that the marital deduction was allowable *notwithstanding the fact that the gift by the surviving spouse transferred the property to persons who would not have taken under the decedent's will, and also gave at least part of it in trust, and not outright, as would have been the case under the will.* "It cannot be said," the Court observed, "that the ultimate disposition of the sum in question was the same as it would have been under the will".

The *Harter* case, we believe, makes it clear that once property has validly "passed" under local law to the surviving spouse (as here), the fact that the spouse subsequently disposes of it to members of the family in a way not contemplated by the will cannot affect the marital deduction. The Tax Court in *Harter*, in effect, reversed its conclusion in the case at bar. Subsequently the Commissioner acquiesced in the *Harter* decision, while the case at bar was pending before the Court of Appeals. See Internal Revenue Bulletin, 1963-34, page 6. It was unconscionable and a violation of due process of law for the Commissioner to acquiesce in the *Harter* case, and thereby accept the Tax Court's reasoning, while pressing before the Court of Appeals here a diametrically opposite theory—which the Court of Appeals accepted (App. A, p. A-6).

V.

A point by point analysis of the Tax Court's opinion reveals no relevant or logical grounds to support the conclusion reached. A determination of a tax deficiency without any reasonable basis is an unconstitutional deprivation of petitioner's property.

We have set forth above our concept of the basic criteria for allowance of the marital deduction, and of the Regulations' provisions and other authorities supporting our view that the deduction in this case was properly claimed. In so doing, we have necessarily noted several crucial errors in the Tax Court's interpretations of fact and conclusions of law.

Since the Court's opinion is not lengthy, we believe it appropriate to analyze the case briefly from yet another point of view, *i.e.*, a point-by-point summary of that opinion.

The Tax Court began its opinion by quoting from the Commissioner's brief, which stated in effect that the power of appointment did not "pass" to the widow, because of the alleged controversy over the French will. Since the Court upheld the Commissioner, we must assume that the Court's subsequent reasoning was designed to establish that the power did not "pass" for this reason. However, if the opinion is considered point-by-point, it is clear that it contains no logical consideration of this issue at all.

After discussing the factual situation, noting that the widow released her power under the American will to settle the supposed controversy over the French will, the Court stated (R. 6a), "Thus, when the estate of the decedent was finally settled, the widow had no power of appointment over the trust corpus here involved."

This statement, although correct, is immaterial. It is not what the widow wound up with that is important; it is what she started with. Whether or not an interest under a will passes is determined at the time the will becomes valid and enforceable, and its dispositive provisions become effective. As we have pointed out, this occurred when the American will was probated, and what the widow later did with interests acquired thereunder is not germane to the issue of whether or not the interest "passed" to her initially. Cf. *Harter* v. *Commissioner, supra.*

Next, after conceding that the issue here is a novel one, the Court stated that "a decedent should not be able to change the marital deduction by using more than one will," citing *Estate of Leo J. Dutcher* v. *Commissioner*, 34 T.C. 918 (1960).

The *Dutcher* case is entirely distinguishable on its facts,[5] but beyond that, it is difficult to understand what possible relevance this reasoning can have to the issue of whether the power "passed" or not. Even its meaning is unclear. Does the statement mean that Dr. Davenport employed two wills since he foresaw the future and intended the ultimate disposition of his property? That Dr. Davenport was possessed of clairvoyant powers, and could look into the future for two years after his death, seems highly unlikely.

Or does the statement mean that if instead of two wills, there had only been one will combining all of Dr. Davenport's bequests and devises, the deduction would have been lost? If that is the meaning, it is certainly immaterial, because there were, in fact, two wills and not just one. Furthermore, it would be sheer unwarranted speculation

[5] In the *Dutcher* case, one of the decedent's wills was being contested in court and the other was still subject to contest at the time of the settlement agreement. Moreover, the property sought to be deducted was *acquired* by the spouse and not *surrendered*.

to assume the same agreement between the parties if there had been only one will. In addition, there is no legal basis for the Court to conclude that even if the same facts surrounded a one-will situation, the marital deduction would be lost. Such a conclusion has not been explored in this case because the facts do not warrant it.

The Tax Court thereupon concluded that Reg. Sec. 20.2056(e)-2(d)(1) refers to "any controversy, with relation to the disposition of his entire estate, settled by the widow giving up some part of the estate subject to United States estate tax which, *but for the controversy*, she would have been entitled to retain." Since the Tax Court did not determine that there was a controversy about the decedent's American or French property, and since, in fact, there was none, this reasoning cannot stand. Moreover, Mrs. Davenport would have been "entitled to retain" the power of appointment, vested under New York law, even if there had been a "controversy" about the French will. She gave it up *of her own volition*, not as a result of a controversy.

Finally, the Court stated that "the widow and the three daughters in effect substituted distributions of property different from that stated in the wills and the substitution relating to the trust estate does not qualify for the marital deduction," citing the *Tebb* case. We have distinguished the *Tebb* case and we have indicated that the Tax Court has already over-ruled Judge Murdock on this point in the *Harter* case.

In summary, although the Tax Court apparently concluded that the power "did not pass" to the widow, nowhere in the opinion do we find any reasoning to support that conclusion. A tax deficiency determined without any rational basis is an unconstitutional taking of petitioner's property.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

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APPENDIX A

Opinion of United States Court of Appeals for the Second Circuit

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 320—October Term, 1962

(Argued June 5, 1963 Decided September 3, 1963)

Docket No. 28041

UNITED STATES TRUST COMPANY OF NEW YORK, Executor, Estate of RALPH SLOCUM DAVENPORT, deceased,
Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Before:

LUMBARD, *Chief Judge*, CLARK, *Circuit Judge*, and ZAVATT, *District Judge*.

Appeal by the executor of the estate of Ralph S. Davenport from a decision of the Tax Court of the United States, J. Edgar Murdock, J., 38 T. C. 670, assessing a deficiency in estate tax in the amount of $87,823.69.

Affirmed.

Opinion of United States Court of Appeals for the Second Circuit

HYMAN L. BATTLE, JR., New York, N. Y. (Charles B. Markham and Battle, Fowler, Stokes & Kheel, New York, N. Y., on the brief), *for petitioner-appellant.*

ROBERT A. BERNSTEIN, Attorney, Department of Justice, Washington, D. C. (Louis F. Oberdorfer, Assistant Attorney General, Lee A. Jackson and I. Henry Kutz, Attorneys, Department of Justice, Washington, D. C., on the brief), *for respondent-appellee.*

LUMBARD, *Chief Judge:*

The sole question in this case is whether certain property left to a surviving spouse, which was relinquished by her in return for an agreement by the decedent's daughters to allow the probate of another will devising French realty to her, qualifies for the marital deduction. We affirm the determination of the Tax Court, 38 T. C. 670 (1962), disallowing said deduction.

The decedent, Dr. Ralph S. Davenport, a United States citizen, died in Paris, France, on July 18, 1955, possessed of property which included real estate situated in France. He sought to dispose of his assets by two testamentary instruments. Under one will executed in May 1949, which was admitted to probate in New York on September 23, 1955, he undertook to pass all his property but the French realty. By this instrument he devised and bequeathed his residuary estate valued at $768,630.01 to his wife, Yvonne, whom he married in 1940, and to his three daughters by a

former marriage, Mrs. Myrian Williford, Mme. Solange du Mortier, and Miss Gisele Davenport, now Mrs. Donald Payne. Each of his daughters and his wife were given 1/6 of the residuary outright. The remaining 1/3 of the residue was placed in trust for the benefit of his wife for life and she was given a general testamentary power of appointment over the corpus.

Dr. Davenport, by a holographic document dated June 28, 1955, sought to devise to his wife his villa, "La Falaise," in Sanary-sur-Mer (Var), France. This will also disposed of other property in France. Under French law, however, Mrs. Davenport's interest was limited to 1/4 of the property unless the daughters executed and filed certain documents with the appropriate French official.

Following arm's-length negotiations between Mrs. Davenport and her stepdaughters, an agreement was reached whereby Mrs. Davenport relinquished her power of appointment over the property left her in trust in return for the stepdaughters' executing and filing the appropriate documents regarding the French realty. Mrs. Davenport and her stepdaughters executed an agreement to this effect on November 8, 1956 and the French will was probated in April 1957.

The executor, the United States Trust Company, petitioner-appellant, filed the Federal Estate Tax return claiming the maximum marital deduction, $374,329.40.[1] As

[1] The value of the property left Mrs. Davenport by the New York will, viz., 1/6 of the residue outright and 1/3 of the residue in trust for life with a general testamentary power of appointment, which would ordinarily qualify for the marital deduction exceeded the maximum marital deduction.

foreign real estate was not then includible in the gross estate, Internal Revenue Code of 1954, § 2033,[2] it could neither be claimed as a marital deduction nor could it bear upon the computation of the maximum marital deduction, Internal Revenue Code of 1954, §2056.

The Commissioner disallowed the value of the property placed in trust, $242,704.52, as a marital deduction on the ground that under Treas. Reg. §20.2056(e)-2(d)(1)[3] it did not pass from the decedent to the surviving spouse in that the general power of appointment, which qualified the trust property for the marital deduction, Internal Revenue Code of 1954, §2056(b)(5), was surrendered by Mrs. Davenport in settlement of a controversy involving her late husband's will. This resulted in the assessment of a deficiency in the amount of $87,823.69. The Tax Court upheld the Commissioner and the executor appeals.

The appellant contends that the trust property "passed" to the surviving spouse upon probate of the New York will and that there was no "will controversy." The theory underlying this argument is that where a decedent elects to dispose of his estate by more than one testamentary instrument Treas. Reg. §20.2056(e)-2(d)(1) is inapplicable to property to which the surviving spouse becomes entitled by virtue of the probate of one such document, notwith-

[2] Amended by PL 87-834 § 18(a)(2)(A), 76 Stat. 1052 (1962) to include foreign real estate in the gross estate.

[3] Treas. Reg. § 20.2056(e)-2(d)(1):

> "Will contests. If as a result of a controversy involving the decedent's will, or involving any bequest or devise thereunder, his surviving spouse assigns or surrenders a property interest in settlement of the controversy, the interest so assigned or surrendered is not considered as having 'passed from the decedent to his surviving spouse'."

standing the fact that this property was subsequently surrendered or assigned by her in settlement of a controversy involving another testamentary document.

While it is true that the regulation in question speaks of "will" in the singular, it is inconceivable that such a narrow construction as urged by appellant was intended. Whether these two testamentary instruments are two "wills" or are a will and a codicil it is clear that they constituted one testamentary plan.

Crucial in qualifying property for a marital deduction is the question of whether it passes from the decedent to one surviving spouse. The medium by which the property passes, whether it be by intestacy, one or more testamentary documents or even by a partial intestacy, is immaterial. The estate is entitled to a marital deduction up to one-half of the adjusted gross estate on property includible in the gross estate and meeting the other statutory requisites which passes from the decedent to the surviving spouse.

When the resolution of a controversy between the beneficiaries regarding the decedent's property culminates in an agreement by which the surviving spouse relinquishes property which qualifies for the marital deduction in return for property which does not so qualify, Treas. Reg. §20.2056(e)-2(d)(1) is applicable. When Mrs. Davenport surrendered her power of appointment over the trust property, it no longer qualified for the marital deduction. The testamentary instrument whereby Dr. Davenport sought to leave "La Falaise" to his wife is a part of his will; that it is embodied in a separate document does not make it any the less so even though by statute foreign realty was

then excluded in computing the federal estate tax.

We find no merit to the appellant's theory that, because under New York law Mrs. Davenport acquired vested rights in the trust property, this property passed to her from the decedent and her subsequent relinquishment of her power of appointment did not affect marital deduction. For federal tax purposes, the federal regulations govern, *Lyeth* v. *Hoey*, 305 U. S. 188 (1938). The regulation is clear: it provides that where an agreement resolving a controversy over the decedent's property entails the assignment or surrender of property by the surviving spouse, said property "is not *considered* as having 'passed from the decedent to his surviving spouse.'" Treas. Reg. §20.2056(e)-2(d)(1). [Emphasis supplied.] No matter how or at what time Mrs. Davenport became entitled to the residue, she did choose to surrender a right to some of decedent's property because she wanted "La Falaise," which was also a part of decedent's estate.

The decision of the Tax Court is affirmed.

Judgment of United States Court of Appeals for the Second Circuit

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York on the third day of September one thousand nine hundred and sixty-three.

Present:

HON. J. EDWARD LUMBARD, Chief Judge,

HON. CHARLES E. CLARK, Circuit Judge,

HON. JOSEPH C. ZAVATT, District Judge.

Estate of Ralph Slocum Davenport, Deceased, United States Trust Company of New York, Executor,

Petitioner,

v.

Commissioner of Internal Revenue,

Respondent.

Appeals from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

Judgment of United States Court of Appeals for the Second Circuit

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed.

A. DANIEL FUSARO
Clerk

by VINCENT A. CARLIN
Chief Deputy Clerk

Order Denying Petition for Rehearing

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the seventeenth day of October, one thousand nine hundred and sixty-three.

Present:

HON. J. EDWARD LUMBARD, Chief Judge,

HON. CHARLES E. CLARK, U.S.C.J.J.

HON. JOSEPH C. ZAVATT, U.S.D.J.

United States Trust Company of New York, Executor, Estate of Ralph Slocum Davenport, deceased.

Petitioner-Appellant,

v.

Commissioner of Internal Revenue,

Respondent-Appellee.

A petition for a rehearing having been filed herein by counsel for the petitioner,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

A. DANIEL FUSARO

Clerk

Order Denying Petition for Rehearing En Banc

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the seventeenth day of October, one thousand nine hundred and sixty-three.

Present:

HON. J. EDWARD LUMBARD, *Chief Judge*,
HON. CHARLES E. CLARK,
HON. STERRY R. WATERMAN,
HON. LEONARD P. MOORE,
HON. HENRY J. FRIENDLY,
HON. J. JOSEPH SMITH,
HON. IRVING R. KAUFMAN,
HON. PAUL R. HAYS,
HON. THURGOOD MARSHALL,
Circuit Judges

United States Trust Company of New York, Executor, Estate of Ralph Slocum Davenport, deceased.

Petitioner-Appellant,

v.

Commissioner of Internal Revenue,

Respondent-Appellee.

A petition for a rehearing in banc having been filed herein by counsel for the petitioner,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

A. DANIEL FUSARO
Clerk

APPENDIX B

Constitution of the United States
Amendment V:

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Internal Revenue Code of 1954
Section 2056(a)

SEC. 2056. BEQUESTS, ETC. TO SURVIVING SPOUSE.

(a) Allowance for Marital Deduction.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsections (b), (c), and (d) be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

Internal Revenue Regulations
Section 20.2056(b)-1(e)(3)

(3) Whether or not an interest is nondeductible because it is a terminable interest is to be determined by reference

to the property interests which actually passed from the decedent. Subsequent conversions of the property are immaterial for this purpose. Thus, where a decedent bequeathed his estate to his wife for life with remainder to his children, the interest which passed to his wife is a nondeductible interest, even though the wife agrees with the children to take a fractional share of the estate in fee in lieu of the life interest in the whole, or sells the life estate for cash, or acquires the remainder interest of the children either by purchase or gift.

Section 20.2056(e)-2(a)

In general, the definition stated in §20.2056(e)-1 is applicable in determining the property interests which "passed from the decedent to his surviving spouse". Special rules are provided, however, for the following:

(1) In the case of certain interests with income for life to the surviving spouse with power of appointment in her (see §20.2056(b)-5);

(2) In the case of proceeds held by the insurer under a life insurance, endowment, or annuity contract with power of appointment in the surviving spouse (see §20.2056(b)-6);

(3) In case of the disclaimer of an interest by the surviving spouse or by any other person (see §20.2056(d)-1);

(4) In case of an election by the surviving spouse (see paragraph (e) of this section); and

(5) In case of a controversy involving the decedent's will, see paragraph (d) of this section.

A property interest is considered as passing to the surviving spouse only if it passed to her as beneficial owner.

except to the extent otherwise provided in §§20.2056(b)-5 and 20.2056(b)-6 in the case of certain life estates and insurance and annuity contracts with powers of appointment. For this purpose, where a property interest passed from the decedent in trust, such interest is considered to have passed from him to his surviving spouse to the extent of her beneficial interest therein.

Section 20.2056(e)-2(d)(1)

(d) *Will contests.* (1) If as a result of a controversy involving the decedent's will, or involving any bequest or devise thereunder, his surviving spouse assigns or surrenders a property interest in settlement of the controversy, the interest so assigned or surrendered is not considered as having "passed from the decedent to his surviving spouse."

Surrogate's Court Act, State of New York
Section 20(6)

20. INCIDENTAL POWERS OF A SURROGATE. A surrogate, in or out of court, as the case requires, has power:

* * * * * *

6. To open, vacate, modify, or set aside, or to enter as of a former time, a decree or order of his court; or to modify or resettle a decree or order of his court to conform its provisions to the decision in writing of the surrogate; or to grant a new trial or a new hearing for fraud, newly discovered evidence, clerical error, or other sufficient cause. The powers conferred by this subdivision must be exercised only in a like case, and in the same manner, as a court of record and of general jurisdiction exercises the same powers.

Appendix B

Section 41-3(a)

41. JURISDICTION OF PERSONS, PUBLIC OFFICERS, COMMISSIONS OR BODIES; WHEN AND HOW OBTAINED. The surrogate's court, in any action or proceeding before it, shall have jurisdiction of the following:

* * * * *

3. Persons of full age who have not been judicially declared to be incompetent to manage their affairs, *and public officers, commissions or bodies.*

a. Who shall, either before or after the filing of the petition waive the issue or service, or both, of the citation by an instrument in writing signed, acknowledged or proved and duly certified.

Section 80

80. FORCE AND EFFECT OF A DECREE OF SURROGATE'S COURT. Every decree of a surrogate's court is conclusive as to all matters embraced therein against every person of whom jurisdiction was obtained. To such decree there is attached all the presumptions pertaining to a judgment rendered by a court of general jurisdiction in a common law action.

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In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 755

ESTATE OF RALPH SLOCUM DAVENPORT, DECEASED, UNITED STATES TRUST COMPANY OF NEW YORK, EXECUTOR, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 3a–7a)[1] are reported at 38 T.C. 670. The opinion of the Court of Appeals (Pet. A1–A6) is reported at 321 F. 2d 908.

JURISDICTION

The judgment of the Court of Appeals was entered on September 3, 1963 (Pet. A1, A7–A8). Petitions for rehearing and rehearing *en banc* were denied October 17, 1963 (Pet. A9–A10). The petition for

[1] Record references are to the appendix to the petitioner's brief in the Court of Appeals.

a writ of certiorari was filed on January 14, 1964. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Where property is bequeathed by the husband, in an American will, in trust for his wife for life with a general power of appointment over the remainder, does the widow's release of the power of appointment in settlement of a contest of the husband's French will (covering property in France) disqualify the trust property from the marital deduction under Section 2056 of the Internal Revenue Code and the applicable Regulations?

STATUTES AND REGULATIONS INVOLVED

Relevant portions of Sections 2033 and 2056 of the Internal Revenue Code of 1954 and Section 20.2056 (e)-2 of the Treasury Regulations on Estate Tax (1954 Code) are set forth in the Appendix, *infra*, pp. 11–13.

STATEMENT

The decedent, a United States citizen, died in Paris, France, on July 18, 1955. He left two wills. One, herein called the American will and executed in May, 1949, disposed of all his property except his property in France. By this instrument he devised and bequeathed his residuary estate valued at $768,630.01 to his wife, Yvonne, and to his three daughters by a former marriage. Each of his daughters and his wife were given one sixth of the residuary estate outright. The remaining one third of the residue was

placed in trust for the benefit of his wife for life and she was given a general testamentary power of appointment over the corpus. The second will, called the French will and dated June 28, 1955, devised to his wife full ownership of his home in France, "La Falaise", and also disposed of other property in France. However, each of the three daughters claimed a one-fourth interest under French law in the French real estate. (Pet. A2–A3; R. 4a.)

The American will was admitted to probate in New York on September 23, 1955. On November 8, 1956, following arm's length negotiations between Mrs. Davenport and her stepdaughters, an agreement was reached whereby Mrs. Davenport relinquished her power of appointment over the property left her in trust in return for the stepdaughters' executing and filing the appropriate documents to effect probate of the French will. (Pet. A3, A4.) The French will was probated in April 1957. (Pet. A3.)

Section 2056(a) of the Internal Revenue Cod of 1954 allows as a deduction from the value of the gross estate of a decedent an amount equal to the value of an interest in property included in the gross estate which "passes or has passed from the decedent to his surviving spouse." Section 2056(b) excludes from the marital deduction interests which are terminable in nature, such as a life estate. Section 2056(b)(5) expressly describes as a qualifying interest a life estate coupled with a general power of appointment in the surviving spouse. Treasury Regulations on Estate Tax (1954 Code), Section 20.2056(e)-2(d)(1),

provide that any property interest assigned or surrendered by a surviving spouse, as a result of a controversy involving the decedent's will or a bequest or devise thereunder, shall not be considered as having "passed from the decedent to his surviving spouse" for the purposes of the marital deduction.

The Commissioner disallowed $242,704.52 of the claimed marital deduction, representing the value of the one-third residuary estate placed in trust for the widow, on the ground that under Treasury Regulations on Estate Tax, Section 20.2056(e)-2(d)(1), it did not pass from the decedent to the surviving spouse because the general power of appointment was surrendered by Mrs. Davenport in settlement of a controversy involving the decedent's will. The resulting assessment of a deficiency in the amount of $87,823.69 was upheld by the Tax Court and by the Court of Appeals. (Pet. A4, A6; R. 7a.)

Both the Tax Court (R. 6a) and the Court of Appeals (Pet. A5-A6) found as a fact that there was a "controversy" over the French will, within the meaning of the regulation. The Court of Appeals rejected the taxpayer's contention that where a decedent elects to dispose of his estate by more than one testamentary instrument, Treasury Regulations, Section 20.2056(e)-2(d)(1) is inapplicable. Passing the question whether the two testamentary instruments here involved should be viewed as two "wills" or as a will and a codicil, the court reasoned that they constituted a single testamentary plan. Accordingly the Court of Appeals concluded that when the widow surrendered

her power of appointment over the trust property, it no longer qualified for the marital deduction (Pet. A4, A5).

ARGUMENT

The decision below is correct and, contrary to petitioner's assertions, no conflict of decisions or denial of due process is involved.

Section 20.2056(e)-2(d)(1), Treasury Regulations on Estate Tax (1954 Code) (Appendix, *infra*, p. 13), is an administrative application of the rationale of the landmark case of *Lyeth* v. *Hoey*, 305 U.S. 188. The essence of the doctrine is that, for federal estate tax purposes, where the compromise agreement represents a *bona fide* recognition of the enforceable rights of an heir or legatee against the estate, it is not the will but the substituted terms of distribution that determine what property passes to the heir or legatee from the decedent within the meaning of the federal estate tax law.

1. Petitioner contends that the decision below is in conflict with other decisions of this Court and of other Circuits "on the applicability of state law in Federal tax matters." (Pet. 8.) The contention is wholly without merit. Of the cases cited by petitioner in this regard, not one involves an issue as to either a marital

[2] Petitioner attempts to dispose of the *Lyeth* doctrine by stating that "the facts of that case are distinguishable" (Pet. 13, fn. 1). In reality, the two cases are quite similar. The property in dispute there was deemed to have passed for federal tax purposes from the decedent to an heir—who received the property after the will had been probated and after the property had vested under state law in another party—since the heir took ultimately under the terms of a settlement agreement.

deduction or a will controversy. Rather, they deal with ordinary income taxes (*Helvering* v. *Stuart*, 317 U.S. 154; *Lincoln Storage Warehouses* v. *Commissioner*, 189 F. 2d 337 (C.A. 3d); *Gould* v. *Commissioner*, 182 F. 2d 573 (C.A. 9th)), excess profits tax (*Graves, Inc.* v. *Commissioner*, 202 F. 2d 286 (C.A. 5th)), documentary stamp tax (*Phillips Petroleum Co.* v. *Jones*, 176 F. 2d 737 (C.A. 10th)), lien priority (*Fidelity & Deposit Co.* v. *New York City Housing Auth.*, 241 F. 2d 142 (C.A. 2d)), and income tax of an estate (*Frederich* v. *Commissioner*, 145 F. 2d 796 (C.A. 5th)).

The only case cited by petitioner in which an estate tax was in issue is *Morgan* v. *Commissioner*, 309 U.S. 78. That case, however, did not involve either the marital deduction or any will controversy; the question was whether a testamentary power of appointment was general (in which case it would be included in the gross estate for tax purposes) or special (in which case it would not be so included). In any event, the decision rejects petitioner's contention that state law is controlling (p. 80):

> * * * we hold that the powers are general within the intent of the Revenue Act, notwithstanding they may be classified as special by the law of Wisconsin.

In at least two further instances, the cases cited by petitioner held, contrary to petitioner's argument here, that the federal tax consequences were to be determined by federal law and not by the characterization of property rights under state law. In *Burnet* v. *Harmel*, 287 U.S. 103, an oil and gas lease, though regarded by state law as a sale of the oil and gas

in place, was held to be not a sale for federal tax purposes. In *Phillips Petroleum Co., supra*, an oil and gas lease, though not regarded as realty under state law, was nevertheless held to be realty for purposes of a federal documentary stamp tax. The other cases cited by petitioner merely acknowledge the obvious; namely, that Congress may, if it sees fit, confer tax consequences on property rights defined by state law. The essential point here, with regard to which the cases cited by petitioner present no conflict, is that federal estate tax law embodies under the circumstances here involved a concept of *passing* under which state probate proceedings, and the vesting of property rights for purposes of state law, are not necessarily determinative. *Lyeth* v. *Hoey, supra.*[3]

2. Petitioner's remaining points attack the decision below as a denial of due process. To the contrary, the decision is based on findings which are amply supported by the evidence, and on conclusions of law which are wholly correct.

As noted in the Statement, *supra*, the court below approved the finding of fact by the Tax Court that there was a controversy over the French will within

[3] In several other instances, Congress has specifically provided by statute for estate tax treatment of certain property which disregards rules of vesting under local law. For example, the following sections of the 1954 Internal Revenue Code provide for inclusion in the gross estate of property interests which under state law vest in someone other than the decedent prior to his death: Section 2035 (transactions in contemplation of death); Section 2036 (transfers with retained life estate); Section 2037 (transfers taking effect at death); Section 2038 (revocable transfers), and Section 2040 (joint interests).

the meaning of the pertinent regulation (Pet. A5–A6). The finding is clearly supported by evidence of record.[1] For example, the taxpayer's own petition in the Tax Court recited (R. 10a) that the daughters "withheld their consent to the probate of the French Will, claiming that the decedent died a French domiciliary and that the French Will was ineffective under French law to give the widow fee title to the decedent's home, La Falaise." The next sentence of the petition (R. 10a) refers to these circumstances as "This dispute." The agreement ultimately entered into by the widow and the daughters (R. 28a–30a) contains the following introductory clause (R. 28a):

> Whereas, some question has arisen or may arise as to the domicile of the decedent at the time of his death, and, as a consequence some question has arisen or may arise as to the enforceability of such of the provisions of the above-mentioned [i.e., French] will of the decedent * * * as direct a distribution to or for the benefit of the spouse * * *

The settlement of "This dispute" resulted in the surrender by the widow of the power to appoint the remainder interest covered by the testamentary trust. Thus, the effect of the settlement for tax purposes was that the remainder interest in the testamentary trust passed directly from the decedent to the daughters and a life estate in the trust passed from the decedent to the widow. The life estate, being a ter-

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[1] In its brief below, petitioner referred to the negotiations over the French will as a "controversy" or as a "dispute" on no less than fifteen occasions.

minable interest, does not qualify for the marital deduction. Section 2056(b) (Appendix, *infra*, pp. 11–12).

The case of *Harter* v. *Commissioner*, 39 T.C. 511, is cited by petitioner in an attempt to demonstrate that the Commissioner has acquiesced in a position inconsistent with the result below. No inconsistency exists.* *Harter* involved wholly different circumstances and a different section of the Treasury Regulations, namely, Section 20.2056(e)–2(e). That regulation provides that where, as in *Harter*, a taxpayer elects to take against his spouse's will, the share of the estate which devolves to him under local law shall qualify for the marital deduction. In other words, under these circumstances, federal law expressly confers tax consequences on certain operations of the local law of succession. In the case at bar, to the contrary, federal law confers tax consequences not on local probate law but on settlement agreements arising out of will controversies. Further, in *Harter* the surviving spouse transferred the property to the children only after the decedent's entire estate had been probated. In the case at bar, as we have seen, the widow's surrender of the power of appointment was a necessary condition precedent to the probate of the French will.

Petitioner further contends that, since the controversy here involved a will devising property in France not includible in the gross estate, the statutes and

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*Even if there were inconsistency, it is not clear by what reasoning petitioner concludes that this would be a denial to it of due process.

Regulations are not applicable. But the question of whether certain property passes to the widow within the meaning of Section 2056 is wholly distinct from the question whether certain other property is includible in the gross estate under Section 2033 (Appendix, *infra*, p. 11). The important point is that the daughters, and not the widow, received the remainder interest in the trust and that this was the consequence of the daughters' standing as heirs and under the compulsion of their unsatisfied claims.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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FEBRUARY 1964.

APPENDIX

Internal Revenue Code of 1954:

SEC. 2033. PROPERTY IN WHICH THE DECEDENT HAD AN INTEREST.

The value of the gross estate shall include the value of all property (except real property situated outside of the United States) to the extent of the interest therein of the decedent at the time of his death.

(26 U.S.C. 1958 ed., Sec. 2033.)

SEC. 2056. BEQUESTS, ETC., TO SURVIVING SPOUSE.

(a) *Allowance of Marital Deduction.*—For purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by subsections (b), (c), and (d), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

(b) *Limitation in the Case of Life Estate or Other Terminable Interest.*—

(1) *General rule.*—Where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed under this section with respect to such interest—

(A) if an interest in such property passes or has passed (for less than an

adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse * * *; and

(B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse;

* * * * * * *

(5) *Life estate with power of appointment in surviving spouse.*—In the case of an interest in property passing from the decedent, if his surviving spouse is entitled for life to all the income from the entire interest, or all the income from a specific portion thereof, payable annually or at more frequent intervals, with power in the surviving spouse to appoint the entire interest, or such specific portion (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), and with no power in any other person to appoint any part of the interest, or such specific portion, to any person other than the surviving spouse—

(A) the interest or such portion thereof so passing shall, for purposes of subsection (a), be considered as passing to the surviving spouse, and

(B) no part of the interest so passing shall, for purposes of paragraph (1)(A), be considered as passing to any person other than the surviving spouse.

This paragraph shall apply only if such power in the surviving spouse to appoint the entire interest, or such specific portion thereof, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

* * * * * * *

(26 U.S.C. 1958 ed., Sec. 2056.)

Treasury Regulations on Estate Tax (1954 Code):

SEC. 20.2056(e)-2. *Marital deduction; definition of "passed from the decedent to his surviving spouse".*

* * * * *

(d) *Will contests.* (1) If as a result of a controversy involving the decedent's will, or involving any bequest or devise thereunder, his surviving spouse assigns or surrenders a property interest in settlement of the controversy, the interest so assigned or surrendered is not considered as having "passed from the decedent to his surviving spouse".

(2) If as a result of the controversy involving the decedent's will, or involving any bequest or devise thereunder, a property interest is assigned or surrendered to the surviving spouse, the interest so acquired will be regarded as having "passed from the decedent to his surviving spouse" only if the assignment or surrender was a bona fide recognition of enforceable rights of the surviving spouse in the decedent's estate. Such a bona fide recognition will be presumed where the assignment or surrender was pursuant to a decision of a local court upon the merits in an adversary proceeding following a genuine and active contest. However, such a decree will be accepted only to the extent that the court passed upon the facts upon which deductibility of the property interests depends. If the assignment or surrender was pursuant to a decree rendered by consent, or pursuant to an agreement not to contest the will or not to probate the will, it will not necessarily be accepted as a bona fide evaluation of the rights of the spouse.

* * * * *

(26 C.F.R., Sec. 20.2056(e)-2.)

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